# STATE OF CONNECTICUT

*INSURANCE DEPARTMENT*

**Testimony of Insurance Commissioner Thomas B. Leonardi**

**Before**
**The Insurance and Real Estate Committee**

**March 13, 2012**

**Raised Bill No. 411 - An Act Concerning the Insurance Holding Company System Regulatory Act.**

Senator Crisco and Representative Megna, committee co-chairs, Senator Kelly and Representative Sampson, ranking members, and Members of the Committee, the Insurance Department appreciates the opportunity to submit testimony in support of Raised Bill 411. I am Thomas B. Leonardi, Insurance Commissioner of the State of Connecticut, and I would like to thank the Committee for raising this initiative on our behalf.

I am pleased to have this opportunity to testify in support of Raised Bill 411, An Act Concerning the Insurance Holding Company System Regulatory Act. It is the Department's objective to adopt a substantially similar version of the NAIC Credit for Reinsurance Model Law, both in substance and structure, and join the other states of this country in having nearly identical wording of this model law as part of a national system of state-based insurance regulation. This objective is undermined when substantial revisions occur between the language which we submit to the committee and that which is ultimately introduced in bill form.

As a bit of background, a holding company system consists of two or more affiliated persons, one or more of which is an insurance company. Of the roughly 7,800 insurance companies regulated by state insurance departments, 78% of these operate within a holding company system. In Connecticut, we have 109 domestic companies and all but one operate within a holding company system.

All states and the District of Columbia have adopted language substantially similar to the National Association of Insurance Commissioners (NAIC) *Insurance Holding Company System Regulatory Act* and its related model regulation. This is required in order for a state to comply with the NAIC Accreditation Program. The provisions in these insurance holding company laws and regulations are designed to regulate mergers and acquisitions, transactions among domestic insurers and other affiliated entities, with explicit standards to safeguard the financial security of the insurer.

In Connecticut, as elsewhere, the Insurance Holding Company Act requires annual filings with the Connecticut Insurance Department regarding the holding company system detailing intercompany contract terms and relationships. In addition, all material management agreements, service contracts and cost-sharing agreements, major reinsurance agreements, material transactions and requests for extraordinary dividends involving the domestic insurer must be filed for the Department's review. In reviewing these transactions, the Department's



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approval or disapproval will be based on whether the transactions comply with the standards in the law and whether they may adversely affect the interests of policyholders.

The Holding Company Act also regulates changes of control of the domestic insurer, by requiring potential controlling owners to receive regulatory approval for changes in control. It does so by specifying minimum financial and non-financial disclosure requirements that must be filed with the Department. The Act sets forth specific criteria under which the Insurance Commissioner may deny a change of control.

State insurance regulators continuously look for opportunities to improve and strengthen insurance group supervision which sometimes results in changes to the *NAIC Model Act and Model Regulation* and the corresponding laws and regulations adopted throughout the United States.

Insurance is one segment of a broader financial services marketplace and has certain interlinkages with banks and other financial firms. The recent global financial crisis offered an opportunity to learn that the activities of non-insurance entities within a holding company system with no connection to the insurers within the group, can still have an impact on the insurers due to the problem of risk concentration in unregulated entities and the consequent contagion and reputational risk. One need only to look to what happened to AIG, when a non-insurance affiliate, through its London trading office, caused the AIG holding company to fail.

U.S. regulators and international standard setting organizations have taken steps to improve the financial services regulatory system and encourage more frequent communication and coordination among financial supervisors, including insurance regulators.

Raised Bill No. 411 makes a number of changes to the Insurance Holding Company Act to update and improve our regulatory objective of safeguarding the financial security of the domestic insurer. The proposed changes we have requested track with the newly revised NAIC *Model Act* and are appended to this testimony. We believe several of the changes will be required in the near future to be adopted in order for a state to remain accredited by the NAIC.

Among the significant changes in the proposal are:

Grants additional authority over holding company activities through the definition of enterprise risk. The Department will gain an overview of the whole group and have the ability to peer through the "window" of the holding company to see how those activities impact the insurer.

Allows for the establishment of supervisory colleges which are created by the Insurance Commissioner to assess a domestic insurer that is part of an internationally active holding company system, for review of their business strategy, financial position, risk exposure, management and governance processes.

The legislation also more closely defines the standards used in determining whether a company acquisition will lessen competition in any line of insurance or create a monopoly.

I appreciate the opportunity to testify in support of Raised Bill No. 411, and I welcome any questions you may have.

**Raised Bill No. 411 - An Act Concerning the Insurance Holding Company System Regulatory Act.**

**Summary**

Section 1 adds definitions to § 38a-129 to include enterprise risk which gives the Department authority to review activities that involve affiliates to assess if risks exist that will adversely impact the financial condition or liquidity of the insurer or holding company. Currently, the Department has only risk focused authority on a "legal entity" basis. This proposal will allow us to identify risks for non-insurance related holding company activities that may impact the insurance company's solvency.

Section 2 amends the provisions of § 38a-130 on acquisition of control to include: (1) requirements for filing information with the Commissioner when a person is seeking to divest controlling interest in a domestic insurer; (2) grants authority for the Commissioner to adopt regulations to determine when an effort to divest or gain controlling interest in an insurer requires approval of the commissioner; (3) requires that the information filed under this section shall remain confidential unless the Commissioner determines that confidential treatment interferes with enforcement; and (5) requirements for proposed acquiring person to file acknowledgment that (A) it will make a good faith effort to ensure the timely filing of the annual enterprise risk report required by § 38a-135(f); (B) that such person and all subsidiaries in the insurance holding company system will provide such information the Commissioner may request to evaluate enterprise risk to the insurance company.

Section 3 amends § 38a-131 to move the existing provisions into § 38a-130 and to add new provisions for pre-acquisition notification involving insurers not covered by the Act, and standards in determining whether the acquisition will lessen competition in any line of insurance or create a monopoly. This section includes definitions of acquisition and involved insurer, defines the scope to include any acquisition in which there is a change in control of an insurer authorized to do business in this state. It also exempts certain practices and requires that the information submitted remain confidential.

Section 3 also outlines standards to be used in evaluating whether an acquisition will lessen competition or tend to create a monopoly. Standards relate to:

- When 2 or more insurers in the same market and prima facie evidence exists that the acquisition will violate competitive standards;
- When market is highly concentrated and the involved insurers possess certain defined percentages of market share;
- If market is not highly concentrated but insurers possess certain defined percentages of market share.
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Commissioner cannot issue cease and desist order or deny the application for the acquisition if: (1) the acquisition results in substantial economies of scale and public benefit exceed those which would arise from not lessening competition; or (2) acquisition increases availability of insurance and public benefit exceeds the benefits which would arise from not lessening competition. This section also outlines the scope of the Commissioner's authority to issue a cease and desist order, what rights an insurer has under this scenario and penalties for violating cease and desist orders.

Section 4 amends § 38a-132 governing hearings and the standards of review for proposed changes of control of domestic insurers by rearranging and revising provisions related to public hearings that are held when there is a change of control of a domestic insurer. Current notice provisions remain the same with the exception of changing 14 days to 7 days for the notice of public hearing to the person filing the statement (the Department often waives this requirement since all parties are already aware of the transaction) .

Section 4 also grants the Commissioner the authority to consolidate hearings when more than one state is involved; allows other state commissioners to participate by phone or in person; and, expressly authorizes the Commissioner to retain experts at the acquiring persons expense.

Section 5 makes non-substantive technical changes to § 38a-133 governing exemptions.

Section 6 amends § 38a-135 governing registration requirements when an insurer is part of a holding company to also include:

- Audited financial statement of holding company system and all affiliates;
- Statements that the board of directors oversee corporate governance and internal controls;
- Statements that senior management approve, maintain and oversee corporate governance and internal control procedures; and
- Any other information required by Commissioner outlined in regulation.

Section 6 also requires the insurer to file an "enterprise risk" report which should identify any material risks within the holding company that would pose a risk to the insurer.

Finally, Section 6 grants the commissioner the authority to participate in supervisory colleges, which are established to assess the business strategy, financial position, legal/regulatory position, risk exposure and risk management/governance processes of individual insurers. It clarifies membership and participation, the functions of the colleges and the role of commissioners, outlines parameters for the coordination of on-going activities and allows for the establishment of a crisis management plan. All expenses of the supervisory colleges are at the insurer's expense.

Section 7 amends § 38a-136 governing standards and management of an insurer within a holding company system to also include:

- Agreement for cost sharing and management services which will be identified by regulation (we currently track cost sharing arrangement but this new language gives us broad authority to identify all cost sharing services);

- Amendments or modifications to affiliate agreements previously filed, subject to materiality standards, along with reasons for the change and the financial impact on the domestic insurer (we currently require this but this new language strengthens our ability to require this);
- Reinsurance pooling arrangements (we currently require this but this new language strengthens our ability to require this);
- Guarantees made by domestic insurers (guarantees are currently addressed in the law § 38a-136(b)(1)), but new language is added to clarify the governing standard;
- Direct/indirect acquisitions or investments which exceed specified threshold (exceeding 2 ½% of insurers surplus to policyholders).

Section 8 amends 38a-137 governing confidential treatment of information provided under 38a-14a (examination of the financial condition of a company); 38a-135 (registration of holding company); and, 38a-136 (transactions between insurance companies and their affiliates). Currently, such information is confidential and is not subject to subpoena. This section expands the Department's authority to maintain documents as confidential to expressly provide that the confidential information shall also not be subject to discovery; or admissible in any civil action. The Commissioner is granted additional authority to use these documents for regulatory and legal actions. Section 8 protects Commissioner or others who have received confidential documents from having to testify in any private civil action.

Section 8 also authorizes the Commissioner to share confidential insurance holding company act information with state, federal and international regulatory and law enforcement officials, the NAIC, the Federal Insurance Office, and members or participants of a supervisory college, as well as to receive and maintain confidential information from such entities.

Section 8 authorizes the Commissioner to enter into written agreements with the NAIC governing the sharing and use of information, documents, materials shared or received pursuant to the insurance holding company act, subject to specified requirements.

Section 9 makes a technical amendment to § 38a-138 authorizing regulations.

Section 10 grants additional authority to the Commissioner when insurers violate the statutes which govern acquisition of controlling interest that prevent the understanding of the enterprise risk to the insurer. If violations occur, they may serve as a basis for disapproving dividends or distributions and for placing the insurer under an order of supervision.

Section 11 amends § 38a-41a to expand the Commissioner's authority to examine insurers that are registered under 38a-135 (registration of insurance holding company members) and its affiliates as to the financial condition of the insurer including the enterprise risk to the insurer. Section 11 also grants authority to the Commissioner to order insurers registered under 38a-135 to produce information not in their possession but that can be obtained through contracts, statutes or other methods. If an insurer cannot produce, it must provide detailed explanation.